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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1962

On Petition For a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

vs.

FEDERAL POWER COMMISSION, MICHIGAN CONSOLIDATED GAS COMPANY, COUNTY OF WAYNE, MICHIGAN, MICHIGAN PUBLIC SERVICE COMMISSION,

Respondents.

BRIEF FOR MICHIGAN PUBLIC SERVICE COMMISSION, RESPONDENT, IN OPPOSITION

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INDEX

	Page
Introduction	1
Argument:	
I. The Criteria Set Forth In The *Detroit* Case And Reaffirmed By The Court Below Are Not Unreasonable.	2
II. The Record Does Not Support The Claim Of Panhandle For A Rate For Its Produced Gas Above That Allowed By The Commission.	6
III. The Commission And The Court Below's Rulings In The Instant Case Are Not Inconsistent With The Area-Price Policy Approved In The *Phillips* Case.	10
Conclusion	13

AUTHORITIES CITED

	Page
1. City of Detroit v. Federal Power Commission, 230 F 2d 810, 11 PUR 3d 113, cert. denied 352 US 829 (1955)	1, 2, 5, 6, 10
2. Federal Power Commission v. Hope Natural Gas Co., 320 US 591	2
3. Panhandle Eastern Pipe Line Co. v. Federal Power Commission, 305 F 2d 763	7, 12
4. Wisconsin v. Federal Power Commission, 303 F 2d 380	3, 10, 11, 12

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Introduction

In Panhandle's petition for writ of certiorari, several questions have been raised in support thereof: First, Panhandle appears to attack the decision of the Court of Appeals for the District of Columbia Circuit rendered in *City of Detroit* v. *Federal Power Commission*, 230 F 2d 810, 11 PUR, 3d 113, cert. denied 352 US 829 (1955). The contention is made that the Federal Power Commission and the Court of Appeals application of the tests laid down in the *Detroit* case results, as a practical matter,

in a return to the conventional cost-rate-base method for rate-making purposes. It is suggested by Panhandle that the decision below is at variance with this Court's holdings in that the reasonableness of Panhandle's rates should be predicated on the "end results." See *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 US 591. Secondly, it is contended by Panhandle, assuming that the criteria set forth in the *Detroit* case are valid, that the Commission was not justified in allowing only actual expenditures for exploration and development of natural gas in Panhandle's cost of service. Panhandle asserts that its cost of service should include the cost of its proposed exploration program even though actual expenditures were not made.

Finally, the assertion is made that the rulings by the Court below are in conflict with its approval in the *Phillips* case (Wisconsin v. Federal Power Commission, 303 F. 2d 380) of the Commission's proposed abandonment of the cost-rate-base method for fixing rates for gas produced by independent producers and the Commission's establishment of an area-pricing policy. It is suggested that there is no rational basis for treating an independent gas producer differently than a pipeline producer.

Argument

I

The Criteria Set Forth In The Detroit Case And Reaffirmed By The Court Below Are Not Unreasonable.

In the proceedings before the Commission which culminated in the *Detroit* case, the Commission approved the rates of Panhandle in which was included in the cost of service an allowance for so-called "field price" or

"commodity value" for the natural gas produced by Panhandle. Pricing the pipeline produced gas at the higher commodity value was for the purpose of encouraging natural gas production by pipeline companies. This was a departure from past practices of the Commission, which had previously used the traditional rate-base approach in determining the rate to be charged for gas produced by a pipeline company. The City of Detroit appealed this determination to the Court of Appeals for the District of Columbia Circuit, contending that the Commission is bound under the Natural Gas Act to use the cost-rate-base method in determining just and reasonable rates. Commenting upon this contention, the Court stated (11 PUR3d 113, 121):

> "The fair field price, which as we have seen results in higher rates than would have resulted from the traditional rate base method, is not an item of cost. Its inclusion as an amount to be recouped from consumers as though it were a cost incurred by Panhandle must find some other justification within the periphery of the 'just and reasonable' standards. It is not an ingredient of any of the usual needs of a regulated utility, that is, to obtain revenues for operating expenses, for preservation of its financial integrity, for capital costs, for servicing of debt and payment of dividends, or for delayed rentals or costs of exploration and development. The commission, however, advances other factors of an economic character as justification. We may not deny these a place in the total structure underlying rates if, in a balancing of investor and consumer interests, they are brought by evidence and findings into rational relationship to what is 'just and reasonable.' And in considering whether the two interests are properly balanced we must keep in mind the basic purpose of the statute to protect consumers

from excessive rates, though at the same time the statute affords the support of public authority to the regulated utility." (Citations and footnotes omitted)

The Court further stated (pages 123 and 124):

"While as we have indicated the commission may be empowered to consider some of these factors it must also, and always, relate its action to the primary aim of the act to guard the consumer against excessive rates. If the commission contemplates increasing rates for the purpose of encouraging exploration and development, or the ownership by pipeline companies of their own producing facilities, it must see to it that the increase is in fact needed, and is no more than is needed, for the purpose. Further than this we think the commission cannot go without additional authority from Congress.

"The amount allowed Panhandle for the encouragement referred to is not shown to meet this test by any evidence and findings. Of course the rate increase attributable to producing properties might have a tendency to encourage their ownership, and perhaps also the development of new sources of production, as an even greater increase also might do. But the question is whether a lesser amount would suffice. The amount here allowed is not brought into relationship by the evidence and findings with the purposes for which it is granted except that it affords a larger revenue to Panhandle than otherwise it would have. This is not an adequate basis for bringing the resulting rates within the 'just and reasonable' standards of the act. The mere fact that the field price method is used does not

vindicate the rates. Its use can be justified only in terms of a demonstrated public interest. In this case an allowance for the desired purposes, assuming they are valid, could be included without resort to the field price system. When the latter method is used the evidence and findings must show that the increase in rates thus caused is no more than is reasonably necessary for the purposes advanced for any increase. Since there is nothing in these proceedings from which such a conclusion could be drawn, they are fatally defective. In other words, we do not substitute 'our opinions for the expert judgment of the administrators to whom Congress entrusted the decision.' We simply say that if the commission is now to abandon the treatment historically accorded pipeline-produced gas in rate making on the ground that the ultimate public interest will be better served thereby, the commission should justify it on the record." (Citations and footnotes omitted)

In effect, the Court held that the Commission was not precluded from using commodity value for pricing pipeline produced gas. However, the Court said that the cost-rate-base method must be used "as a point of departure." The *Detroit* case further stated that allowances granted by the Commission above what would be allowed under the cost-rate-base method must find some justification in the record made before the Commission. It is submitted that the above criteria are not unreasonable in setting rates for a pipeline gas producer and, as will be shown subsequently, the application of these criteria to Panhandle by both the Commission and the Court below is fully supported by the record.

II

The Record Does Not Support The Claim Of Panhandle For A Rate For Its Produced Gas Above That Allowed By The Commission.

In the *Detroit* case, the Court remanded the matter back to the Commission in order to give Panhandle an opportunity to present evidence in justification of rates above those allowable under a conventional cost-rate-base approach. Panhandle introduced evidence which purported to show that, during the period from January 1, 1955, to August 31, 1958, it substantially over-produced its gas wells. The contention was made that an additional exploration and development program should have been undertaken during this period, but was not done so because there was no assurance that the Commission would fix rates sufficiently high to underwrite this program. Panhandle argued that in order to maintain the deliverability consumed during the 1955-1958 period, it needed about $5,000,000 per year for a four-year period. Evidence was presented of a proposed expansion program for the period 1960-1964. Panhandle contends that such program is necessary in order to replace the deliverability loss during the 1955-1958 period when no substantial exploration program was undertaken. Evidence was also presented by Panhandle designed to show that no excessive rate of return would result if the proposed investments in its exploration program were made and if the Commission allowed Panhandle the commodity value of its produced gas.

These arguments, advanced by Panhandle before the Commission, were disposed of in the following manner (R 430):

> "In our opinion, Panhandle's proposed program of future expansion during the 1960-1964 period is not competent to test rates in effect January 1, 1955, to August 31, 1958, on the basis of a test year ending October 31, 1954. There is no reason why Panhandle's customers during the refund period should be charged with a future expansion program. In another proceeding in setting rates for the future, we would not necessarily hold a natural-gas company to expenditures confined to the test year. However, we are here asked to make allowance for an exploration and development program which admittedly was not carried out during the test year or the subsequent refund period and is merely proposed for a later period."

The Court below upheld the decision made by the Commission in *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 305 F 2d 763, realizing in part that the issues involved should be left to the expert judgment of the administrative agency, by stating (see page A6 of Petition):

> "Forceful as Panhandle's contentions are, we are not persuaded that the Commission has erred. We think that the Commission was not obliged on the record made to grant a larger allowance than it did, and that it left the door open for a more liberal treatment in future years on a more persuasive record. Certainly it was entitled to reject the claim based on hypothetical development costs not actually incurred. Especially is this so in light of Panhandle's failure in fact to carry out a full exploration program, the availability of other methods of financing development, and the difficulty of insuring that the funds from a rate increase attributable to granting the requested development allowance would actually go into exploration and development.

> "The issues raised here involve a delicate balancing by the Commission of the interests of the company, its shareholders, the consumers, and the public. After careful consideration, we are unable to say that the method of computation selected by the Commission was unjust, unreasonable, or not conductive to proper exploration and development."

The essence of Panhandle's position is that it should be permitted to charge against ratepayers of a prior period items in its cost of service which were not, in fact, expended during the period in question. Panhandle states that this should be done because it does not want to make these expenditures without assurances that such expenditures will be included in its cost of service. It is difficult to see how this position can be taken in the face of the following statement made by the Commission (page 7, *supra*):

> "In another proceedings in setting rates for the future, we would not necessarily hold a natural-gas company to expenditures confined to the test year."

As can be seen, the Commission declined to consider hypothetical expenditures in fixing rates involving a past period. The Commission clearly explained the peculiar position taken by Panhandle by saying (page 7, *supra*):

> ". . . we are here asked to make allowance for an exploration and development program which admittedly was not carried out during the test year or the subsequent refund period and is merely proposed for a later period."

It is patent that the Commission and the Court below have acted reasonably in not permitting rates to gas consumers to be predicated upon hypothetical costs not actu-

ally incurred by the pipeline company. Contrary to what Panhandle appears to imply, the rates approved by the Commission were not determined exclusively by reference to a conventional rate-base approach, but rather by the evidence in the record. The following significant statement is made by the Commission on this point (R 432):

> "We recognize that the test required by the court in the *City of Detroit* case is a difficult one in that it contemplates a showing of what is needed above the cost of service in order to encourage exploration and development. We think that a new approach is necessary for the pipeline producers as well as the independent producers. In this proceeding, however, we have not established an area price and Panhandle has not shown that it should be allowed the commodity price as an additional allowance over the cost of service. Panhandle must, therefore, depend upon the cost of service evidence with necessary adjustments, as a basis for determining an allowance for its own produced gas."

As indicated above, the Commission has stated unequivocally that, in a proper case, it would allow exploration and development expenditures even though not made during the test year. In fact, in the instant case the Commission did just this. The Commission actually made an upward adjustment in the exploration and development expenses to recognize those expenditures made subsequent to the test period. The Commission has also indicated that, in setting rates for the future, it would not necessarily confine its determination to matters relating to the test year. In spite of these statements and assurances, Panhandle still insists upon an allowance of proposed exploration and development expenditures in the form of commodity value for its produced gas as a prerequisite for actually making such expenditures. It is difficult to see how Panhandle can insist

on the customers paying for its exploration program prior to the time the program is undertaken. This, indeed, is a most novel position.

The above considerations sufficiently demonstrate the validity of the holding in the *Detroit* case that commodity value for gas produced by pipeline companies should be allowed only if supported by the record. The Commission and the Court below have both held that Panhandle has utterly failed to support its contention that the rates approved by the Commission should be sufficiently high enough to provide Panhandle with funds to pay for an exploration and development program, which in fact has not commenced.

III

The Commission And The Court Below's Rulings In the Instant Case Are Not Inconsistent With The Area-price Policy Approved In The Phillips Case.

Panhandle contends that there is some inconsistency between the treatment by the Commission and the Court below with respect to the pricing of gas produced by an independent producer and by a pipeline company. It is suggested that the commodity-value method advocated by Panhandle in the instant proceedings is essentially the same as the area-price policy promulgated by the Commission and approved by the Court. Therefore, it is argued that the Court below could not approve area pricing and at the same time disapprove commodity value. This would undoubtedly be true (1) if there were no material differences between the problems relating to an independent producer and those relating to a pipeline producer; and (2) if the factors which were considered in developing area pricing

are the same as those which went into the development of commodity value.

In distinguishing between the treatment of independent producers and pipeline producers, the Commission recognized the enormous difficulty involved in attempting to apply a cost-rate-base method approach to the independent producers. In addition, the Commission noted the administrative burden of attempting to extend traditional rate-making principles to several thousand independent producers of natural gas. However, as we have noted above, the Commission has not foreclosed the possibility of treating pipeline and independent producers alike in the future, if this is indicated on the basis of experience. In fact, the area-pricing policy promulgated by the Commission is on an interim basis and is subject to change.

Another weakness in Panhandle's argument as to the inconsistency of the Court's ruling in the instant case, with its determination of the *Phillips* case, is an attempt to equate commodity value with area price. The Commission's Statement of General Policy initiating area prices specifically states that it is based on considerations of all relevant facts, including cost information for all decided and pending cases, existing and historical price structures, volume of production, trends of production, price trends in the various areas over a number of years, trends in exploration and development, and trends in demand and the available markets for gas. These considerations embrace a broader scope than Panhandle's commodity value which relates to average contract prices for the sale of gas in fields where Panhandle produces gas, and which Panhandle seeks to support by hypothetical costs of its proposed exploration program. Therefore, the Commission is not inconsistent in denying commodity value and at the same time promulgating an area price policy.

Assuming, *arguendo*, that the *Phillips* and *Panhandle* cases are in conflict, this does not mean that there are, necessarily, substantive grounds for *certiorari*. In the *Phillips* case, the Commission announced a policy of area pricing applicable to independent gas producers. This policy was prospective. Commodity value is advocated by Panhandle in support of the rates collected under bond from January 1, 1955, to September 1, 1958. In effect, Panhandle is asking this Court to require the Commission to apply the commodity-value principle as of January 1, 1955, because of some alleged conflict with the *Phillips* case. However, it should be noted that the Commission did not announce its area-pricing policy until September 28, 1960. The point we are making is this: Even if there is a conflict between the *Panhandle* and *Phillips* cases, the refusal of the Court to allow commodity value, based upon the record, for a period from 1955 to 1958 is not in conflict with the *Phillips* case, since the area-pricing policy was promulgated subsequent to this period.

Conclusion

For the reasons stated, the Michigan Public Service Commission respectfully requests this Court for a denial of the petition for writ of certiorari.

Respectfully submitted,

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